STATE OF SOUTH CAROLINA

(Caption of Case)

Annual Review of Purchased Gas Adjustment and Gas Purchasing Policies of Piedmont Natural Gas Company, Inc.

BEFORE THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

COVER SHEET

DOCKET NUMBER: 2012 - 4 - G

(Please type or print)

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DOCKETING INFORMATION (Check all that apply)

☐ **Emergency Relief demanded in petition**

☐ **Request for item to be placed on Commission's Agenda expeditiously**

☐ **Other:**

INDUSTRY (Check one)	NATURE OF ACTION (Check all that apply)		
☐ Electric	☐ Affidavit	☐ Letter	☐ Request
☐ Electric/Gas	☐ Agreement	☐ Memorandum	☐ Request for Certification
☐ Electric/Telecommunications	☐ Answer	☐ Motion	☐ Request for Investigation
☐ Electric/Water	☐ Appellate Review	☐ Objection	☐ Resale Agreement
☐ Electric/Water/Telecom.	☐ Application	☐ Petition	☐ Resale Amendment
☐ Electric/Water/Sewer	☐ Brief	☐ Petition for Reconsideration	☐ Reservation Letter
☒ Gas	☐ Certificate	☐ Petition for Rulemaking	☐ Response
☐ Railroad	☐ Comments	☐ Petition for Rule to Show Cause	☐ Response to Discovery
☐ Sewer	☐ Complaint	☐ Petition to Intervene	☐ Return to Petition
☐ Telecommunications	☐ Consent Order	☐ Petition to Intervene Out of Time	☐ Stipulation
☐ Transportation	☐ Discovery	☒ Prefiled Testimony	☐ Subpoena
☐ Water	☒ Exhibit	☐ Promotion	☐ Tariff
☐ Water/Sewer	☐ Expedited Consideration	☐ Proposed Order	☐ Other:
☐ Administrative Matter	☐ Interconnection Agreement	☐ Protest	
☐ Other:	☐ Interconnection Amendment	☐ Publisher's Affidavit	
	☐ Late-Filed Exhibit	☐ Report	

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Before the
Public Service Commission of South Carolina

Docket No. 2012-4-G

Annual Review of Purchased Gas Adjustment and Gas Purchasing Policies
of
Piedmont Natural Gas Company, Inc.

Testimony
of
Sarah E. Stabley

On Behalf Of
Piedmont Natural Gas Company, Inc.

Piedmont Natural Gas

June 11, 2012

Q. Please state your name and your business address.

A. My name is Sarah E. Stabley. My business address is 4720 Piedmont Row Drive, Charlotte, North Carolina.

Q. By whom and in what capacity are you employed?

A. I am employed by Piedmont Natural Gas Company, Inc., (Piedmont) as the Manager of Gas Supply and Wholesale Marketing.

Q. Please describe your educational and professional background.

A. I graduated from Queens University of Charlotte in May of 2004 with a Bachelor's of Arts Degree in Business Administration. I joined Piedmont as a Collector/Meter Reader in our field operations in December of 1998. In March 2001 I took a position in Gas Control as a Schedule Confirmation Analyst. In November 2004 I was hired as a Gas Supply Representative in the Gas Supply department. In 2008 I was promoted to Manager of Gas Supply & Wholesale Marketing.

Q. Please describe the scope of your present responsibilities for Piedmont?

A. My current major responsibilities are supervision of long and short-term purchasing of supply and secondary wholesale marketing.

Q. Have you previously testified before this Commission or any other regulatory authority?

A. No.

Q. What is the purpose of your testimony in this proceeding?

A. My testimony will describe Piedmont's gas purchasing policies. This testimony is in response to the Commission's directive issued in Order No. 88-294 dated April 6, 1988 requiring ". . . annual public hearings . . . to review the Company's . . . gas purchasing policies" and in response to the Commission's Order establishing pre-filing deadlines in this docket.

Q. What is the period of review in this docket?

A. The review period is April 1, 2011 through March 31, 2012.

Q. Please explain Piedmont's gas purchasing policies.

A. Piedmont has previously utilized and continues to maintain a "best cost" gas purchasing policy. This policy consists of five main components, 1) the price of the gas, 2) the security of the gas supply, 3) the flexibility of the gas supply, 4) gas deliverability, and 5) supplier relations. As all of these components are interrelated, we continue to weigh the relative importance of each of these factors when developing the overall gas supply portfolio to meet the needs of our customers.

Q. Please describe each of the five components.

A. 1) The "price of the gas" refers to the final cost of gas once delivered to Piedmont's city gates. With the unbundling of the interstate pipeline industry, substantial flexibility exists in structuring gas supply arrangements. The majority of Piedmont's supply purchases take place at "pooling points" into the pipeline on which Piedmont holds firm transportation capacity rights. In the case of "bundled" city gate supply purchases, Piedmont may pay the gas supplier an all-inclusive price that covers the cost of gas, fuel and transportation charges. Of course, peaking and storage services may add additional injection, withdrawal, and related fuel charges to the city gate cost of gas. In order to accurately assess prices at a comparable transaction point, Piedmont evaluates purchase prices at the receipt point and adds the applicable transportation costs associated with delivery to our pipeline city gate points which in turn deliver into Piedmont's distribution facilities. Any "best cost" analysis that solely considered supply area or "pooling point" cost would fail to recognize the varying cost in fuel and commodity costs associated with transporting gas purchased from different supply area locations to Piedmont's city gates. All of these cost components must be taken into account in evaluating the "price of the gas."

2) "Security of gas supply" refers to the assurances that the supply of gas will be available when required. It is imperative to maintain a high level of supply security for Piedmont's firm customers who have no alternate fuel capability. Security of gas supply is less important for our interruptible customers who have access to alternate fuels. Fixed reservation fees are generally required, in addition to the commodity cost of gas, in order to contract for and reserve firm gas supplies. In addition, the geographic source of supply, the nature of the supplier's portfolio of gas supplies, and negotiated contract terms must be considered when evaluating the level of

supply security. Thus, the security of gas supply is interrelated with the price of gas as well as other components of Piedmont's "best cost" purchasing policy.

3) "Flexibility of gas supply" refers to our ability to adjust the volume of a particular gas supply as operating and market conditions change. For example, firm heat-sensitive customers will vary their consumption depending on the weather conditions in Piedmont's service area. Interruptible customers will vary their level of purchase depending on the price of alternate fuels and the demand for product in their own industry. Thus, Piedmont must arrange a portfolio of gas supplies and storage service flexible enough to meet the daily and monthly "swings" in the market place. Contractual "swing rights" are implemented through monthly and daily elections with gas suppliers and through injections into and withdrawals out of storage.

4) "Gas deliverability" refers to the ability to deliver Piedmont's gas supplies at the city gate through reliable transportation and storage capacity arrangements. The unbundling of the interstate pipeline industry has created a complex system of multiple pipeline services and service combinations. Transportation arrangements can involve *intra*state pipeline transportation, interstate pipeline transportation, interstate pipeline storage arrangements, interstate pipeline lateral lines, interstate pipeline pooling services, and interstate pipeline balancing and peaking services. The marketplace for

pipeline capacity service is static, with little to no unused capacity available during periods of high demand conditions such as extreme cold or hot weather conditions. Consequently, it is important that we secure and maintain firm transportation and storage capacity rights to ensure the deliverability of our gas supplies to meet the design day, seasonal, and annual needs of our customers. Pipeline transportation and storage capacity contracts require the payment of fixed demand charges to reserve firm transportation and/or storage entitlements. Piedmont is active in proceedings at the Federal Energy Regulatory Commission (FERC) not only with respect to the level of pipeline charges under these contracts, but also the tariff terms and conditions that apply to these pipeline services.

5) "Supplier relations" refers to the dependability, integrity and flexibility of a particular gas supplier. We contract with gas suppliers who have a reputation of honoring their contractual commitments and have proven themselves as reliable suppliers. Conversely, we avoid suppliers which have a reputation of defaulting on contract obligations or who unilaterally interpret contracts to their advantage. We prefer to deal with suppliers who are constantly looking for ways to improve service and offer "win-win" solutions for meeting customer needs.

Q. Please describe the arrangements under which Piedmont purchases gas.

A. Piedmont purchases gas supplies under a diverse portfolio of contractual arrangements with a number of reputable gas producers and marketers. In general, under Piedmont's firm gas supply contracts, Piedmont pays negotiated reservation fees for the right to reserve and call on firm supply service up to a maximum daily contract quantity (elected either on a monthly or daily basis), with market-based commodity prices. These market-based commodity prices, to which Piedmont's gas supply contracts refer, are published daily, weekly, and monthly in industry trade publications. These firm contracts may range in term from one month to four years. Longer term contracts may provide for periodic reservation fee renegotiations. Some of these contracts are for winter only (peaking or seasonal) service, summer only (peaking or seasonal) service, or 365 day (annual) service. Firm gas supplies are purchased for reliability and security of service. The reservation fees associated with firm gas supply may vary according to the amount of nomination flexibility built into the contract (daily swing service generally being more expensive than monthly baseload service). Prior to or when existing supply contracts expire, requests for proposals (RFP's) are sent to potential suppliers, their responses evaluated, and firm gas supplies are then contracted with suppliers whose proposals best fulfill Piedmont's "best cost" purchasing policy.

Piedmont also purchases gas supplies in the spot market under contract terms of one month or less. These contracts provide for less supply security in that they may be interruptible and short term in nature. As a result, Piedmont relies on these contracts primarily for interruptible or spot markets during off-peak periods when secondary supplies are more abundant and for supplemental system balancing requirements. Because of the nature of spot contracts, these supplies do not command reservation fees and are priced on a commodity basis, generally by reference to an industry index or at negotiated fixed prices.

Q. How does the interrelationship of the five factors described above determine the character of the supply and capacity contracts under your "best cost" policy?

A. Under our "best cost" policy, we attempt to secure and maintain a supply portfolio that is in balance with the requirements of our sales markets. Because our firm sales market must have a secure and reliable gas supply, we meet the needs of this market primarily with long-term firm supply, transportation, storage, and peaking service contracts. The temperature sensitivity of the firm market necessitates that flexibility of supply and storage also be provided. As mentioned earlier, firm gas supply contracts demand a premium, typically in the form of fixed reservation fees. Also, firm supply contracts with flexibility of swing service entitlements will command a higher reservation fee than baseload arrangements. Because our interruptible market is more price sensitive and requires less supply security, we supply this market with off-peak firm gas supply and transportation services when the firm market demand declines and through the purchase of gas supplies in the spot market.

In short, before entering into any agreement to purchase gas supply, pipeline transportation capacity, or storage capacity, we carefully consider the requirement for the supply and weigh the five "best cost" factors (price, security, deliverability, flexibility, and supplier relations). A great deal of judgment is required when weighing these factors and to help us exercise this judgment, we try to keep informed about all aspects of the natural gas industry. We intervene in all major FERC proceedings involving our pipeline transporters, stay in constant contact with our existing and potential suppliers, monitor gas prices on a real-time basis, subscribe to industry literature, follow supply and demand developments, and attend industry seminars.

Q. What is your greatest challenge in applying your "best cost" gas purchasing policy?

A. Since most major gas supply decisions require a considerable degree of planning and must be made a year or more in advance of service, our greatest challenge is dealing with future uncertainties in a dynamic global, national, and regional energy market. Future demand for gas is affected by economic conditions, customer conservation efforts, weather patterns, regulatory policies, and industry restructuring in the energy markets. In addition, the future availability and pricing of gas supplies will be affected by overall end-user demand, oil and gas exploration and development, pipeline expansion and storage projects, and regulatory policies and approvals.

Q. Please explain the Company's position regarding the current U.S. supply situation.

A. For much of the first decade of this Century, wholesale futures pricing of natural gas reflected by the NYMEX was extremely volatile. Peak pricing for futures contracts occurred in July, 2008 when contracts for gas to be delivered during January, 2009 sold for $14.516 per dekatherm. Due to the significant and largely unexpected quantities of shale gas that have become available to the market in the last several years, the wholesale futures price of natural gas has declined dramatically. It is Piedmont's expectation that some volatility will remain in the wholesale market, particularly related to force majeure type events or significant changes in demand, but that the dramatic swings previously seen in the wholesale futures market are not likely to recur with the same regularity or intensity so long as shale gas supplies remain abundant and regulatory policies remain favorable for gas and oil exploration.

Q. Please explain the factors that the Company evaluates in determining the pricing basis for its gas supply contracts. Please discuss the various pricing alternatives available, such as fixed prices, monthly market indexing and daily spot market pricing and describe how supplier

reservation charges and discounts or premiums from market prices enter into the evaluation.

A. The Company has various pricing options available to it when developing its gas supply portfolio. These options include monthly market indexing, daily spot pricing and fixed pricing. Pricing for gas contracted for a term of one month or longer refers to a monthly or daily index as published by industry trade publications. Prices for daily spot deals may refer to a daily index or a negotiated fixed price.

The reservation fee the Company pays for each contract in its firm supply portfolio is dependent upon the pricing options chosen and the supply flexibility requirements associated with each contract. Reservation fees are generally lower for base load supplies (purchased at a constant volume for the entire month, season or year) and higher if swing service is required. Reservation fees also vary depending on the type of swing service being provided. Examples of factors which affect the cost of swing service are: 1) the number of days of swing required; 2) the volume of swing allowed; 3) commodity pricing at first of the month indices versus daily spot pricing; 4) first of the month keep whole pricing; 5) next day versus intraday swing capabilities; and 6) location of the supply being purchased.

The Company considers its anticipated load and swing requirements under various weather scenarios, measuring the exposure to price fluctuations of the spot market and the factors listed above and makes a "best cost" purchasing decision.

Q. Please describe how the Company determines the daily contract quantity of gas supplies that should be acquired through long-term contracts for the whole year, the full winter season and periods less than a full winter season.

A. The Company will purchase gas supplies on a year-round basis to fulfill its firm requirements including storage injections and to minimize supply costs utilized to serve both firm and interruptible markets. Some of these contracts will escalate in volume during shoulder months and the winter period (November through March) as the Company's firm requirements increase due to colder weather, thus sculpting year-round contracts to fit seasonal needs. The Company also purchases volumes for the winter period to match its firm transportation capacity entitlements, which also increase during the winter period. Lastly, the Company may purchase short-term city gate peaking supply to fulfill additional firm obligations as the Company experiences peak day firm demand requirements. The Company also reviews warm winter weather scenarios to measure its ability to fulfill its contractual purchase commitments with suppliers.

Q. Please explain the provisions in the Company's gas supply contracts that allow or help facilitate future renegotiation efforts if future market conditions offer new opportunities and describe any contractual

restraints that prevented the Company from obtaining the full benefit of favorable spot market conditions during the review period.

A. All of the Company's supply contracts have market-based commodity prices tied to indices published in industry trade publications. These commodity pricing provisions allow the Company to obtain the full benefit of market priced gas.

Q. What process does the Company employ in selecting its firm gas suppliers?

A. The Company identifies the volume and type of supply that it needs to fulfill its market requirements and solicits requests for proposals (RFP's) from a list of suppliers that the gas supply department continuously updates as potential suppliers enter and leave the market place. The RFP's may be for firm baseload or swing supply. RFP's for swing supply may be further categorized into pricing based on first of the month indices, keep whole, or daily market indices. Swing supplies priced at first of the month indices command the highest reservation fees because suppliers incur all the risk associated with market volatility during the delivery period. Keep whole contracts require the Company to reimburse suppliers for the difference between first of the month index prices and lower daily market prices if the Company doesn't take its full contractual volume. Because the Company assumes the volatility risk associated with falling prices, a lower reservation fee is warranted. Lower reservation fees are also associated with swing contracts based upon daily market conditions because both buyer and seller assume the risk of daily market volatility. After forecasting the ultimate cost delivered to the city gate for each point of supply, and evaluating the cost of reservation fees associated with each type of supply and its corresponding bid, the Company makes a "best cost" decision on which type of supply and supplier is best suited to fulfill its needs.

Q. Did the Company enter into any new supply arrangements during the review period.

A. Yes. As is typically the case, during the review period the Company added new seasonal or year-round supply utilizing its normal RFP process described earlier.

Q. Please describe the process that Piedmont utilized and the market intelligence evaluated during the review period to determine the prices charged for off-system sales.

A. The process and information used by Piedmont in pricing off-system sales depends upon the term of the sale, the type of sale and prevailing market conditions at the time of the sale. For long-term delivered sales (longer than one month), Piedmont solicits bids from potential buyers and awards volumes based on the bids received. For short-term transactions (daily or monthly) Piedmont 1) monitors prices and volumes on the Intercontinental Exchange (Intercontinental Exchange or "ICE" is an electronic trading platform where potential buyers post bids and potential sellers post offers at various locations/areas along the pipelines), 2) talks to various market participants on the telephone or communicates with them via instant messenger, and 3) for less liquid trading points, estimates prices based on price relationships with more liquid points. The Company will also evaluate the amount of supply available for sale and weigh that against current market conditions in formulating its sales strategy (i.e., if Piedmont has a large amount of supply to sell on a particular day and determines that market demand is low, the Company will be more aggressive in its sales strategy). The Company incorporates all these factors and then initiates sales via "ICE", over the telephone or instant messenger.

Q. Did Piedmont make any changes in its gas purchasing policies or practices during the period of review?

A. Piedmont did not implement any changes in its "best cost" gas purchasing policies or practices during the test period.

Q. Did the Company take any other action to reduce price volatility for its customers?

A. The Company continues to utilize the Company's approved Hedging Plan, as detailed in Mr. Maust's Testimony, and storage as a physical hedge to stabilize cost. The Company's Equal Payment Plan, in addition to the use of the PGA benchmark price and deferred gas cost accounting, also provide a smoothing effect on gas prices charged to customers.

Q. What are some of the other steps Piedmont has taken to manage its gas costs consistent with its "best cost" policy during the review period?

A. During the past year, Piedmont has taken the following additional steps to manage its gas costs, consistent with its "best cost" policy:

(1) Piedmont has, as more fully described in Mr. Maust's testimony, actively participated in proceedings before the FERC and other regulatory agencies that could reasonably be expected to affect Piedmont's rates and services;

(2) Piedmont has utilized the flexibility available within its supply and capacity contracts to purchase and dispatch gas, release capacity and initiate secondary marketing sales in the most cost effective manner, resulting in South Carolina capacity release and secondary market sales credits of $3,529,631.76;

(3) Piedmont has actively promoted more efficient peak day use of natural gas and load growth from "year-round" markets in order to improve the Company's load factor and reduce average unit costs.

Q. Please summarize your testimony.

A. Piedmont's "best cost" purchasing policy provides ratepayers with secure, reasonably priced gas supplies to meet the requirements of its customers. This policy and Piedmont's practice under this policy have been reviewed and found prudent on all occasions in South Carolina and the other state jurisdictions in which we operate. Although we believe our policies and procedures are reasonable, we are cognizant of the fact that the natural gas industry is rapidly changing, and we are constantly monitoring our policies and procedures to keep up with, and even anticipate, these changing conditions. We have and will continue to work with the Commission and ORS Staff to review current regulations and tariffs and explore possible changes that will better serve our natural gas customers in the future. We are satisfied that our existing policies and procedures are prudent and that they have produced and will continue to produce adequate amounts of reasonably priced gas for our customers.

Q. Does this conclude your testimony?

A. Yes.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the attached documents are being served this date via email and UPS Overnight (via email and U.P.S. Overnight) upon:

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This the 11th day of June, 2012.

s/ James H. Jeffries IV
James H. Jeffries IV